



STATE BOARD OF EQUALIZATION
STAFF LEGISLATIVE BILL ANALYSIS

Date Amended:	04/14/04	Bill No:	AB 1789
Tax:	Property	Author:	Corbett
Board Position:		Related Bills:	SB 1748 (Ducheny) SB 1532 (Aanestad)

BILL SUMMARY

This bill would allow boards of supervisors to exempt from property tax personal property used by certain life science entities during a specified startup period.

Summary of Amendments

The amendments since that last analysis provide that the jobs created must pay a living wage and provide benefits, as specified, and requires county boards of supervisors to consult with affected local agencies prior to granting the exemption.

Current Law

Article XIII, Section 2 of the California Constitution authorizes the Legislature to classify personal property for differential taxation for exemption by means of a statute approved by a 2/3 vote of the membership of each house.

Currently, there are no special assessment provisions or exemptions for any personal property that is owned by a life science entity.

Proposed Law

This bill would add Section 242 to the Revenue and Taxation Code to authorize a county, upon a majority vote of its board of supervisors and after consultation with local agencies within the geographical boundaries of that county, to exempt from property taxation qualified personal property used in the facility of a qualified life science entity during the qualified startup period of that qualified life science entity.

Qualified personal property means property used in a qualified manufacturing facility during the startup period of that qualified manufacturing facility that meets all of the following requirements:

- The property is directly involved in the manufacturing process in this state. Property used in an activity that is incidental, preliminary, or subsequent to the manufacturing process is excluded.
- The use of the property will lead to the creation of at least 25 full-time new manufacturing jobs or positions that last for at least five years and

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- The compensation paid to persons employed in those jobs or positions will be equal to or greater than the living wage, as defined, paid in California to persons employed in those industries described in Codes 325411 to 325414, inclusive, of the NAICS, and
- The persons employed in those jobs or positions will be covered by a policy of employer-sponsored health benefits that meet the minimum requirements set forth in Chapter 2.2 (commencing with Section 1340) of Division 2 of the Health and Safety Code.

Qualified life science entity means a life science company engaged in biopharmaceutical activities or other biotechnology activities that are described in Codes 325411 to 325414, inclusive, of the North American Industry Classification System (NAICS) Manual published by the United States Office of Management and Budget, 2002 edition, including, but not limited to, the manufacture or development of medicinal chemicals, medicinal products, biopharmaceutical preparations, in vitro and in vivo diagnostic substances, and biological products.

Qualified manufacturing facility means a facility owned and operated by a qualified life science entity that, on or after January 1, 2005, begins construction in this state of a facility for the manufacture of medicinal chemicals, medicinal products, biopharmaceutical preparations, in vitro diagnostic substances, in vivo diagnostic substances, or biological products.

Qualified startup period means the period of time commencing from the date a qualified life science entity begins construction of a qualified manufacturing facility within this state and ending on the date that the qualified manufacturing facility of that qualified life science entity receives validation from the federal Food and Drug Administration.

In General

Business Personal Property. Personal property used in a trade or business is generally taxable, and its cost must be reported annually to the assessor on the business property statement as provided in Revenue and Taxation Code Section 441. Personal property is not subject to the valuation limitations of Proposition 13. It is valued each lien date at current fair market value.

Generally, the valuation of personal property is based on the acquisition cost of the property. The acquisition cost is multiplied by a price index, an inflation trending factor based on the year of acquisition, to provide an estimate of its reproduction cost new. The reproduction cost new is then multiplied by a percent good factor (from a percent good tables) to provide an estimate of the depreciated reproduction cost of the property (reproduction cost new less depreciation). The reproduction cost new less depreciation value becomes the taxable value of the property for the fiscal year.

For the most part, only businesses are subject to the property taxation of their business personal property holdings. With the exception of boats and planes, personal property owned by individuals is exempt from personal property taxes.

As stated, personal property used in businesses is subject to property tax. Current exemptions provided for personal property used in businesses are limited to business inventories (Section 219) and the first \$50,000 of employee-owned hand tools (Section 241).

Detailed information on the assessment of business personal property is available in Assessors Handbook 504, "Assessment of Personal Property and Fixtures."

<http://www.boe.ca.gov/proptaxes/pdf/ah504.pdf>

Local Incentive Options

Capital Investment Incentive Payments. In 1998, Senate Bill 566 (Ch. 616, M.Thompson) added Government Code Section 51298 to provide a new competitive tool that cities and counties may employ to negotiate property tax rebates with high tech manufacturing companies. Under these provisions, local governments could cap the taxable value of any new high tech manufacturing plant at \$150 million annually for up to 15 years. Local government would then charge the manufacturer an annual "community services fee" of about \$2 million.

This program can only be activated by a majority vote of the local governing body. The California Trade and Commerce Agency certifies that the capital investment exceeds \$150 million and is a qualified manufacturing facility. Businesses described in Standard Industrial Classification (SIC) Codes 3500 to 3899 are eligible for the program. Special districts and school districts may also participate in the payment of capital investment incentive payments, although they may not make payment of an actual allocation.

A Community Services Agreement (CSA) dictates community service fee remittances, in amounts equal to 25 percent of the capital investment incentive amount calculated for that proponent for that fiscal year. This fee shall not exceed \$2 million in any fiscal year. Employees at the facility specified in the CSA must be covered by an employer sponsored health benefits plan and the average weekly wage, exclusive of overtime, shall not be less than the state average weekly wage. The "state average weekly wage" means the average weekly wage paid by employers to employees covered under unemployment insurance, as reported to the Employment Development Department for the four calendar quarters ending June 30, 1997.

Economic Revitalization Manufacturing Property Tax Rebates. Between 1993 and 2003 a property tax rebate program existed that allowed cities, counties, and special districts to rebate all or some of property taxes paid on personal property that was deemed to be "economic revitalization manufacturing property." Revenue and Taxation Code Section 5108 permitted local governing bodies to rebate some or all of the property tax revenue that local agencies would receive from "economic revitalization manufacturing property" for a period of five fiscal years from the date the property was placed in service. Tangible personal property had to be directly involved in the manufacturing process, the project had to lead to the creation of 10 new full-time manufacturing jobs, the company had to pay wages of at least \$10 per hour and those jobs were to be in continuous existence for the duration of the rebate. Local agencies included cities, the county, city and county, and special districts - except for school districts. These provisions sunset on January 1, 2003.

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Background

Related Bills. During the 2003 Legislative Session, AB 913 (Corbett) was introduced which included intent language to enact a program that would specify the manner in which newly constructed real property used for biopharmaceutical manufacturing is assessed for purposes of property taxation. No action was taken on this bill.

COMMENTS:

1. **Sponsor and Purpose.** This bill is sponsored by the author to provide a tool to retain and attract biotechnology manufacturing in California by providing a permissive partial personal property tax exemption for new biotechnology manufacturing facilities.
2. **Summary of Amendments.** The April 14 amendment provides that the jobs created must pay a living wage and provide benefits, as specified, and requires county boards of supervisors to consult with affected local agencies prior to granting the exemption.
3. **The taxation of personal property is discretionary with the Legislature.** Section 2 of Article XIII of the California Constitution provides that the Legislature, two-thirds of the membership in each house concurring, may exempt any personal property from taxation. In contrast, real property exemptions generally require a constitutional amendment. Proposed Section 242 creates such an exemption for personal property used by an eligible company during the defined startup period.
4. **Currently there are no special personal property exemptions for any particular industry.** Thus, this bill would set a precedent that others will likely seek to emulate.
5. **Property Tax Incentives.** Exemption from property tax as an economic development incentive in California has not been widely used. To exempt real property from property tax requires a constitutional amendment. To overcome this prohibition, the idea of a property tax rebate has been recently introduced. Government Code Section 51298 authorizes local governments to make payments equivalent to certain property taxes paid. This provision of law is intended to provide local governments opportunities to attract large manufacturing facilities in high tech, aerospace, automotive, biotechnology, software, environmental sources and other industries to their California counties. Another provision of law, which has recently become inoperative, was specific to personal property. It provided a property tax rebate on "economic revitalization manufacturing property". (See and former Revenue and Taxation Code Section 5108.)
6. **County Option.** Only a county board of supervisors could approve this personal property exemption. A decision to exempt eligible personal property from taxation would be binding on all the cities, special districts and schools located within that county. A city competing for a new facility in a county that has not yet enacted the exemption could not guarantee that the local county board of supervisor would ultimately enact one.

7. **Real Property Fixture or Personal Property?** A fixture is an item of personal property that when affixed to the real property shifts in classification from personal property to real property. A tool, machine, equipment, appliance, device or apparatus used in the facility of a qualified life science entity that is classified as a real property fixture would not be exempt under this bill. The line of demarcation between a real property fixture and personal property is not always clear and often requires the exercise of judgment. Classification is an area of frequent dispute in instances where the classification results in different tax treatment. The availability of a property tax exemption of only property that is classified as personal property will likely increase such disputes.
8. **Related Bills.** SB 1748 (Ducheny) would create "The Economic Development Incentives Act" which would allow the governing body of a local agency to grant an economic development incentive to a private manufacturing entity located, or committed to locating, within the local agency's jurisdiction. The amount of the incentive granted to a private manufacturing entity would be some or all of the additional property tax revenue that the local agency would receive from the entity's economic revitalization manufacturing property for a period of five fiscal years from the date the property was placed in service. The incentive would be limited to personal property. SB 1532 (Aanestad) would create a property tax rebate for fish screens required to be installed due to environmental laws.

COST ESTIMATE

The Board would incur some minor costs in informing and advising county assessors, the public, and staff of the change in law.

REVENUE ESTIMATE

Background, Methodology, and Assumptions

According to information provided to the Assembly Select Committee on Biotechnology on February 5 of this year, as many as 240 new medicines could reach the market by 2007. Further, according to the Biotechnology Industry Organization, a Washington D.C.-based trade association, as of 2001, more than 2,200 biotech products had reached the final stages of FDA approval. With the number of new drug applications in the pipeline, the biotechnology industry is transitioning from research and development to manufacturing. The manufacturing process requires additional investment to construct, supply, and operate manufacturing facilities.

We have not been able to determine a supportable estimate on the amount of personal property used in a manufacturing facility that would qualify under this proposal. However, according to industry representatives, about \$1.5 to \$3.6 million in new equipment would be used in a medium-size qualified manufacturing facility during the start-up period. The start-up period is estimated to last from 1 to 5 years. The property tax loss from exempting this equipment would amount to \$36,000 (\$3.6 million x 1%) by the end of the start-up period.

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As indicated previously, more than 2,200 biotech drug products are in the final stages of FDA approval. The California biotech industry comprises more than half of all US biotech companies. California is the birthplace of biotechnology and has remained the epicenter of the biotech industry revolution for more than 25 years. As an order of magnitude, if 25% (or 550) of the 2,200 biotech drug products currently in the pipeline for FDA approval were manufactured in California, the personal property that could qualify during the start-up period would amount to as much as \$1.98 billion (\$36,000 x 550). The revenue impact of exempting this personal property would amount to \$19.8 million. This estimate assumes that all counties, having a qualified manufacturing facility within its jurisdiction having met all other statutory requirements pursuant to this bill, would approve the exemption.

Revenue Summary

We have not been able to determine a supportable estimate on the amount of personal property used in a manufacturing facility that would qualify under this bill. As an order of magnitude, if 25% (or 550) of the 2,200 biotech drug products currently in the pipeline for FDA approval were manufactured in California, the personal property that would qualify during the start-up period could amount to as much \$1.98 billion. The revenue impact of exempting this personal property would amount to \$19.8 million.

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